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In the Supreme Court of the United States

OCTOBER TERM, 1979

FIRST INVESTMENT ANNUITY COMPANY OF AMERICA, INVESTMENT ANNUITY, INC., PETITIONERS

v.

G. WILLIAM MILLER, SECRETARY OF THE TREASURY OF THE UNITED STATES, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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OPINIONS BELOW

The memorandum opinions of the district court (Pet. App. B 21a-60a) are reported at 437 F. Supp. 1095 and 442 F. Supp. 681. The opinion of the court of appeals (Pet. App. A 1a-20a) is reported at 609 F. 2d 1.

JURISDICTION

The judgment of the court of appeals (Pet. App. C 65a) was entered on October 5, 1979. By order dated January 3, 1980, the Chief Justice extended the time within which to file a petition for a writ of certiorari to February 19, 1980, and the petitions were filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether an action for a judgment declaring invalid the Internal Revenue Service's revocation of favorable private letter rulings previously issued with respect to the tax treatment of investment annuity contracts sold by petitioners and for an order enjoining enforcement of the revocation of the prior rulings is barred by the tax exception to the Declaratory Judgment Act, 28 U.S.C. 2201, and the Anti-Injunction Act, 26 U.S.C. 7421.

STATUTES INVOLVED

The pertinent provisions of Sections 801(g) and 7421 of the Internal Revenue Code of 1954 (26 U.S.C.) and 28 U.S.C. 2201 are set forth at Pet. App. D 68a-69a.

STATEMENT

1. Petitioner First Investment Annuity Company of America (FIAC)[1] was organized by its former parent corporation, Investment Annuity, Inc. (IAI), for the purpose of issuing and marketing tax shelters known as investment annuity contracts. Petitioners instituted this action in the United States District Court for the District of Columbia seeking a declaratory judgment that Rev. Rul. 77-85, 1977-1 Cum. Bull. 12, is invalid, and an injunction against enforcement of the ruling.

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[1]Petitioner IAI was the parent corporation of petitioner FIAC at the time the complaint was filed in the district court. Subsequently, IAI sold all of its FIAC stock to Life Insurance Company of North America. IAI and FIAC have filed separate petitions for certiorari.

FIAC began marketing investment annuity contracts in 1965. Under these contracts, an investor transfers assets to a custodian account, pursuant to an agreement which provides the investor with substantial control over the assets and the income therefrom, and which contemplates the ultimate purchase of an annuity funded by the assets in the custodian account.[2] In a series of private letter rulings beginning in 1965, the Internal Revenue Service ruled that the investment earnings of the custodial accounts were not currently taxable to the respective

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[2]The specific details of the investment annuity arrangement were as follows: The investment annuity contract established a custodial account with a third party (usually a bank) into which the policyholder transferred a minimum amount (in cash or other assets) that he could supplement at any time prior to the starting date of the annuity. The assets in the account were nominally the property of the insurance company, and were pledged to the purchase of an annuity. The company also received a percentage of the assets as an annual premium on an annuity policy. Any assets remaining in the account at the policyholder's death became the company's property as a terminal premium. The assets in the account were invested at the direction of the policyholder. While investment options were limited to those on an approved list, such lists normally included publicly traded securities, government obligations, certificates of deposit, savings accounts, commercial paper, and life insurance. The policyholder could at any time direct the custodian to sell, purchase or exchange assets held in the account, and to reinvest income. The policyholder also retained the power to direct the voting of the securities or to exercise any other rights pertaining to the assets. While the assets in the custodial account could not be returned directly to the policyholder, full or partial surrender of the annuity policy was permitted prior to the starting date. In those circumstances, the custodian would sell the assets and pay the proceeds over to the insurance company, which in turn would pay them to the policyholder less any cash surrender charges. Should the policyholder die before the starting date, the custodial account would be liquidated and the proceeds paid to the policyholder's beneficiaries in the same manner (Pet. App. A 3a).

policyholders-investors, but were taxable to the insurance company. These rulings held that the policyholder's tax on the investment income was deferred until the income was received by him in the form of the annuity payments that would be forthcoming under the contract. The position taken in these rulings rested upon the determination that the assets in the policyholder's custodial account were owned by the insurance company and not the policyholder (Pet. App. A 4a).

During the initial period following the issuance of the Internal Revenue Service's rulings, FIAC's sales of investment annuity contracts were relatively modest. Subsequently, however, business and financial publications heralded the contracts as permitting investors to avoid taxation on investment earnings while retaining control and liquidity with respect to their assets.[3] The company's sales of the investment annuities thereupon increased dramatically (Pet. App. A 4a). As a result of the extensive publicity proclaiming investment annuities as the ideal tax shelter and the substantial increase in the sales of such annuities, the Internal Revenue Service began to reconsider its rulings that the investment earnings from custodial accounts were currently taxable to the insurance company rather than the policyholder (Pet. App. A 4a-5a).

[3]The purported ability to obtain tax deferral while retaining control over the invested assets prompted the financial press to characterize the investment annuity the "wraparound" annuity because it permitted investors to defer current income merely by "wrapping" an annuity around an existing investment (Pet. App. A 5a).

On March 9, 1977, the Service issued Rev. Rul. 77-85, which revoked the prior favorable tax treatment accorded investment annuity policyholders. The new ruling held that because of the substantial incidents of ownership retained by the investment annuity policyholder with respect to the assets in his custodial account, the policyholder, and not the insurance company, was the owner of those assets for federal tax purposes. The ruling therefore concluded that the policyholder was currently taxable on the earnings from the custodial account. At the urging of representatives of FIAC, however, the ruling contained a "grandfather" provision, as authorized by Section 7805(b) of the Internal Revenue Code, permitting continued favorable tax treatment for existing policyholders provided they made no contributions to their custodial accounts after March 9, 1977 (Pet. App. A 5a).

Following the issuance of Rev. Rul. 77-85, representatives of companies selling investment annuities sought legislation to delay the effective date of the ruling for one year so that industry members could seek permanent legislation reversing the position taken in the ruling. Although a Senate floor amendment to H.R. 3477, the Tax Reduction and Simplication Bill of 1977, would have so delayed the effective date of the ruling (J.A. 162-167),[4] Congress rejected the proposal on May 3, 1977 (J.A. 148-161).

2. Shortly thereafter, petitioners filed this suit. The government moved to dismiss the action on the ground that it was barred by the Anti-Injunction Act and the tax exception to the Declaratory Judgment Act. In response, petitioners asserted that because existing contracts had

[4]"J.A." refers to the joint appendix filed in the court of appeals.

been "grandfathered" by the Service and because further sales of contracts were not feasible, the validity of Rev. Rul. 77-85 could not be litigated in a suit for redetermination of a deficiency in the Tax Court or in a refund suit. Petitioners claimed that the validity of the Commissioner's ruling would never be subject to judicial review if their action were dismissed.

The district court agreed with petitioners that the Anti-Injunction Act and the tax exception to the Declaratory Judgment Act were not "intended to preclude pre-enforcement review of Service actions where the action will otherwise *never* be subject to judicial review" (Pet. App. B 27a) (emphasis in original). The court, however, was not convinced that judicial review could not otherwise be obtained. Accordingly, the district court directed petitioners to seek the permission of the Pennsylvania Insurance Commissioner and the Securities and Exchange Commission to sell a single additional policy to a cooperative purchaser, who could then challenge the ruling in a refund suit.[5] When these authorities refused to permit the sale of a new policy for the purpose of arranging a test case,[6] the district court

[5]In anticipation of the issuance of Rev. Rul. 77-85, the Pennsylvania Insurance Commissioner notified FIAC on March 8, 1977, that no further sales of investment annuity contracts could be made without his prior approval. On March 7, 1977, the SEC rescinded the "no-action" letter upon which FIAC had been relying in selling its annuity contracts. FIAC ceased selling investment annuity policies as of March 8, 1977, and has made no sales of those policies since that date.

[6]The Insurance Commissioner's refusal to approve an additional sale, even for the purpose of permitting a test case, was premised on his evaluation that the public interest would best be served by a speedy resolution of the controversy by means of the instant

concluded that no other access to judicial review of the ruling was feasible and denied the government's motion to dismiss (Pet. App. B 34a-37a). Thereafter, the court held that Rev. Rul. 77-85 was invalid, and enjoined the Internal Revenue Service from enforcing the ruling to the extent it would increase the tax liability of investment annuity purchasers (Pet. App. B 38a-64a).

The court of appeals reversed and remanded the case to the district court with instructions to dismiss the complaint for lack of jurisdiction. It held that the decisions of this Court made it clear that the Anti-Injunction Act is to be given literal effect unless the plaintiff meets the two-part test set forth in *Enochs* v. *Williams Packing Co.*, 370 U.S. 1 (1962). There, this Court held that no suit may be brought to enjoin the assessment and collection of taxes unless equity jurisdiction otherwise exists and under no circumstances could the government prevail on the merits of its claim. Here, petitioner FIAC had not even contended that its case came within the *Williams Packing* exception. Moreover, petitioner IAI had failed to support its assertion that it met the two-part *Williams Packing* test. The court of appeals therefore concluded that the plain terms of the Anti-Injunction Act barred the suit (Pet. App. A 1a-20a).

Finally, the court rejected petitioners' contention that dismissal of the suit deprived petitioners of property without due process. In this respect, the court concluded

declaratory judgment action in the district court, rather than through a more time-consuming third-party refund suit (Pet. App. A 15a; J.A. 188-191, 225-226). The SEC's refusal to reinstate its "no action" letter was based on the actions of the Insurance Commissioner. There is nothing in the record to suggest that the SEC would block the sale of an additional policy in the event the Insurance Commissioner were to grant permission for such a sale (Pet. App. A 15a; J.A. 199).

that Rev. Rul 77-85 did not infringe upon any constitutionally protected property right of petitioners because the issuance of the ruling did not increase petitioners' tax liability but only that of their policyholders. The court therefore held that even on the assumption that petitioners had no other means to obtain judicial review of the validity of ruling, the application of the Anti-Injunction Act to bar petitioners' action did not violate their right to due process (Pet. App. A 13a-14a).

ARGUMENT

I. The decision below correctly held that petitioners' suit to enjoin the enforcement of Rev. Rul. 77-85 was barred by the Anti-Injunction Act.[7] That statute explicitly states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person * * *" (Pet. App. D 69a). In so concluding, the court of appeals properly followed the well-settled line of decisions of this Court ruling that the literal language of the Act prohibits such injunctive actions unless the plaintiff can show: (1) that equity jurisdiction otherwise exists; and (2) that under no circumstances can the government prevail on the merits of its claim. *Enochs* v. *Williams Packing Co.*, 370 U.S. 1 (1962); *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974); *Commissioner* v. *"Americans United", Inc.*, 416 U.S. 752 (1974); *United States* v. *American Friends Service Committee*, 419 U.S. 7 (1974).

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[7]The court of appeals also held that the language of the Declaratory Judgment Act (28 U.S.C. 2201), excepting all suits "with respect to Federal taxes," "is, if anything, more restrictive" than the Anti-Injunction Act (Pet. App. A 7a). However, because it concluded that the reach of the two Acts is coterminous, its analysis focused on the Anti-Injunction Act.

Here, petitioners do not contend that they are able to meet the second part of the *Williams Packing Co.* test and show that under no circumstances would the government prevail on the merits of its claim. But despite this Court's consistent adherence to the *Williams Packing Co.* test as the sole exception to the flat prohibition of the Anti-Injunction Act, petitioners urge that there is a further exception for those parties having no other access to judicial review.[8] In support of this argument, petitioners rely upon this Court's statement in *Bob Jones University* v. *Simon*, *supra*, 416 U.S. at 746, that "[t]his is not a case in which an aggrieved party has no access at all to judicial review. Were that true, our conclusion might well be different."

But as the court of appeals correctly recognized (Pet. App. A 12a), this Court's statement in *Bob Jones University* concerning the unavailability of judicial review was made in the context of a hypothetical case in which a

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[8]For purposes of its decision, the court of appeals assumed that because of the Pennsylvania Insurance Commissioner's refusal to permit the sale of an additional policy for the purpose of arranging a policyholder refund suit, petitioners would not be able to obtain judicial review of Rev. Rul. 77-85 in the event this suit were dismissed.

It is by no means certain, however, that a refund suit challenging the ruling will never be possible. As the court of appeals pointed out (Pet. App. A 15a, n.28), the Pennsylvania Insurance Commissioner's action in blocking a sale to a cooperative third party was premised on his evaluation at that time that the public interest would best be served by a speedy resolution of the tax issue by means of this injunctive action rather than through the slower process of a refund suit. Accordingly, should this Court deny certiorari, the Pennsylvania Insurance Commissioner may well change his assessment and permit a test refund suit by an investor to proceed.

taxpayer has no access to the courts to contest his own tax liability. Here, however, petitioners' tax liabilities are not at issue. Indeed, the Commissioner's ruling relieves them of tax liability on the income earned by the assets placed in the custodial accounts and imposes such liability on the investors. There is accordingly no basis in *Bob Jones University*, or elsewhere, for petitioners' claim that the Anti-Injunction Act is not applicable to suits by persons who may be adversely affected by the Commissioner's actions pertaining to the tax liabilities of third parties where such third parties cannot or will not contest the Commissioner's determination in the courts.[9] See *EDUCO, Inc.* v. *Alexander*, 557 F. 2d 617 (7th Cir. 1977).

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[9]As the court of appeals correctly noted (Pet. App. A 14a), there are numerous instances in which administrative actions by the Internal Revenue Service may adversely affect individuals or organizations whose own tax liabilities are not involved. For example, imposition of a greater tax on a corporation may mean smaller dividends to the shareholders; increases in tax on their customers may adversely affect suppliers; increases in taxes on employers may adversely affect their employees. Moreover, in many situations such collaterally affected parties may have no access to judicial review of the administrative action. Thus, prior to the enactment of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2841, there was as a practical matter no effective appeal from a determination by the Service that a proposed issue of municipal bonds was taxable, since the absence of a favorable ruling invariably makes it impossible to market the bonds and since direct suit by the state or local government challenging the ruling was not possible. See S. Rep. No. 95-1263, 95th Cong., 2d Sess. 533-534 (1978). To remedy this situation, Congress added Section 7478 to the Code, which allows a state or local government to obtain a declaratory judgment in the Tax Court as to the tax status of a proposed issue of municipal bonds.

Petitioners' situation is similar to that of the issuers of municipal bonds prior to the enactment of Section 7478. But Congress has not seen fit to lift the bar of the Act and the tax exception to the Declaratory Judgment Act in the circumstances of this case.

2. Petitioners further argue (Pet. 14-19) that the application of the Anti-Injunction Act to bar their suit violates their right to due process. But as the court of appeals correctly concluded (Pet. App. A 13a-14a), the issuance of Rev. Rul. 77-85 did not deprive petitioners of any property right cognizable under the Constitution. "To have a property interest in a benefit, a person clearly must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it." *Board of Regents* v. *Roth*, 408 U.S. 564, 544 (1972). See also *Arnett* v. *Kennedy*, 416 U.S. 134 (1974); *Bishop* v. *Wood*, 426 U.S. 341 (1976).

Here, the issuance of the ruling did not deprive petitioners of any benefit to which they had a vested claim. Rev. Rul. 77-85 did not increase petitioners' tax liability; nor did it prohibit continued sales of petitioners' investment annuities policies. To the contrary, the ruling did no more than revoke the private letter rulings previously issued to petitioners, in which the Service had ruled that earnings from custodial accounts were not currently taxable to petitioners' policyholders.

Petitioners' due process argument necessarily rests upon the proposition that the issuance of the private rulings created a property interest cognizable under the due process clause of the Fifth Amendment.[10] But as the

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[10]Petitioners' claim that Rev. Rul. 77-85 deprived them of a property interest conferred by statute, *i.e.*, Section 801(g) of the Internal Revenue Code of 1954, begs the question. The ruling, of course, holds that petitioners' annuity policies do not meet the definitional requirements of Section 801(g). The only contrary authority, at the time the ruling was issued, was the private letter rulings issued by the Service to the petitioners. It is therefore apparent that the ruling did not deprive petitioners of a right conferred by statute but rather merely reversed the Service's own administrative interpretation of the law.

decision below correctly recognized (Pet. App. A 14a), the private rulings were simply an expression of the Service's interpretation at that time of the application of the tax laws to holders of investment annuity policies issued by petitioners. The rulings did not have the force of law and created no obligation for the Internal Revenue Service to adhere in the future to that position. See *Dixon* v. *United States*, 381 U.S. 68 (1965); *Automobile Club* v. *Commissioner*, 353 U.S. 180 (1957); *Wisconsin Nipple & Fabricating Corp.* v. *Commissioner*, 581 F. 2d 1235 (7th Cir. 1978); *Stubbs, Overbeck & Associates* v. *United States*, 445 F. 2d 1142 (5th Cir. 1971). To the contrary, as petitioners acknowledge (Pet. 17), the rulings were subject to revocation at any time. *Dixon* v. *United States*, *supra*. Thus, although the letter rulings created a benefit, petitioners had no property right to that benefit. Instead, as in *Board of Regents*, *supra*, there simply was a unilateral expectation on petitioners' part that the benefit conferred by the rulings would continue indefinitely. However, such an expectation does not rise to the level of a constitutionally protected property interest.

Finally, petitioners assert (Pet. 19-22) that the court of appeals' application of the Anti-Injunction Act is unconstitutional because it removes jurisdiction from all courts to determine the validity of Rev. Rul. 77-85 and thus results in a delegation of unlimited legislative power to the Internal Revenue Service. But the authority of Congress to determine the extent to which suits against the United States will be permitted is a consequence of the doctrine of sovereign immunity. While this doctrine may yield in a case where the actions of the United States or its officials implicate a constitutionally protected property or

liberty interest of the complainant, there is, as we have shown, no such protected interest involved here. Accordingly, the application of the Anti-Injunction Act to bar petitioners' suit is fully in accord with the requirements of the Constitution.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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